

CITY MANAGER'S OFFICE

17555 PEAK AVENUE
MORGAN HILL, CA
95037-7128

TEL: 408-779-7271

FAX: 408-779-1592

WWW.MORGAN-HILL.CA.GOV

DATE: July 1, 2002

TO: City Council

SUBJECT: Fiscal Year 2002/03

Dear Mayor Kennedy and Members of the City Council:

I am pleased to submit the City Manager's Recommended Budget for Fiscal Year 2002/03. The budget is a plan to meet community needs through effective use of the City's available resources. It reflects the City Council's commitment to fiscal responsibility through long term prudent financial planning. The goals of this strategy are to maintain a prudent level of reserves, to cost effectively provide municipal services, and to pre-fund known expenditure expectations.

The current budget document and Capital Improvement Program (CIP) provide a proactive, forward-looking program to address the dynamic needs of our City. We have the opportunity, based on the City's revenue stream and financial reserves, to maintain a high level of services to the public and to move forward on a number of fronts to effectively plan and implement public programs and services.

Nonetheless, this recommended budget reflects a continuing slowdown in revenues. It was necessary to hold vacant positions open and unfilled and to significantly cut back on investment in capital equipment. Additional revenues were achieved through an update of the cost allocation plan. The budget also proposes staffing, operational costs, and revenues needed to open the new Cultural and Community Center. In the end, it was still necessary to use \$262,564 from the reserve Designated for Economic Uncertainty.

ECONOMIC AND DEMOGRAPHIC PROFILE

The City of Morgan Hill provides a high quality residential community for our many citizens who commute north to their jobs. Population increased by 2.08% as of January 1, 2002 compared to the prior year, to a level of 34,785, according to the State Department of Finance.

The economic success of Silicon Valley impacts our residents through relatively high family income. However, the recession has caused higher unemployment throughout the Silicon Valley and a reduction in sales and business visitors. The top 40 employers employed approximately 6,000 persons in Morgan Hill at July 2001, as reported to the City on business license tax returns. The median price for a single family home in Morgan Hill fell from \$519,000 for calendar 2000 to \$507,000 in calendar 2001 and the monthly median during 2002 has ranged from \$460,000 in February to \$535,000 in March. An encouraging sign is that, after falling from a monthly average of 37 sales for 2000 to a monthly average of 25 for 2001, the average monthly sales volume for the first three months of 2002 has risen to 51.



The City provides a broad range of services, including police protection, development and housing, water and sanitation services, streets and parks construction and maintenance, planning, engineering, code enforcement, recreation, general city administration, and support services. The City has contracted with Santa Clara County to provide fire protection services and with South Valley Disposal and Recycling to provide solid waste collection services.

As the local economy slowed, the City's policy of establishing prudent reserves makes good financial sense. The State of California is currently struggling to confront a deficit estimated at \$20 billion, so it is unlikely that the City will receive significant new financial assistance from the State in the near future and it is possible that the State might divert revenue that would normally go to local

Budget Message (continued)

government. Sales tax revenue has declined by approximately 6% in FY 2001/02, as projected, to a level of approximately \$5.2 million. Growth of approximately 2.5%, to a new level of \$5.3 million, is projected for 2001/02. Transient occupancy tax revenue has plummeted by 36% in 2001/02, as projected, to a new level of \$870,000. Growth of approximately 2.5%, to a new level of \$892,000, is estimated for 2002/03.

BUDGET PROCESS

The Fiscal Year 2002/03 Budget is based upon an in-depth analysis of actual and projected fund balances, revenues, and expenditures. Each City department prepared line item detail for each of their activities and recommended certain service levels and activity goals for the 2002/03 Budget year. The Finance Department prepared revenue projections based upon input from other departments. The City Manager then reviewed individual departmental requests, prioritized activities based upon City Council policy, and made certain adjustments. At the conclusion of this process, the proposed budget was prepared and is being submitted to the City Council for review.

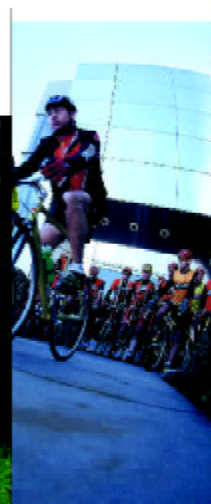
BUDGET HEADLINES

- Pursue State funding for new Library
- Complete construction of new Community & Cultural Center and Playhouse
- Complete preliminary/final design for: Indoor Recreation Center, Library, Aquatics Center, & Sports Complex
- Acquire property & work with Santa Clara County to develop Morgan Hill Courthouse
- Assist Morgan Hill Community Health Foundation to provide medical services

- Implement 40 Developmental Asset Approach as framework to guide youth-related programs
- Support Morgan Hill Community Foundation to further recreation and arts programs
- Expand the Police Officer Housing Assistance Program to include teachers and city employees
- Meet emerging community expectations by implementing an e-government strategic plan
- Open the Community & Cultural Center & begin classes, activities and special events
- Assign a second school resource officer within Police Department
- Complete Gateway Plan and Design Guidelines for the entry points to community
- Complete Update of Downtown Plan
- Complete Greenbelt Study
- Develop voter amendments to City's Residential Development Control System (Measure P)



Comprised of more than 79,000 acres, Henry W. Coe State Park is the second largest state park in California and a popular spot for camping, backpacking, fishing, hiking, mountain biking, and horseback riding.



Morgan Hill provides the opportunity for year-round recreational activities including cycling, golfing and hot air ballooning.



Morgan Hill is expanding its community amenities to include a community center, aquatics center, library and recreational facilities.

Budget Message (continued)

- Complete Murphy Avenue Corridor Study
- Implement an auto dealer marketing strategy
- Implement audit recommendations from development processing audit
- Expand curbside recycling program to include plastics 3-7, scrap metals, and other materials
- Implement expanded business license audit program by using new data bases
- Select and implement a new financial system software package
- Complete design of new police facility and develop detailed Police Facility Master Plan
- Begin construction of the 72-unit "Church Street" mixed-use housing and office project
- Add more E-government resources to website to increase community access to City services
- Provide 24 hours of enhanced training to every employee
- Compile core competencies for all City employees and recruit & select for those competencies
- Complete two new City water reservoirs
- Complete and implement City's Comprehensive Housing Strategy
- Complete drilling of new water well at Boys Ranch
- Implement GASB 34 financial statement reporting for fiscal year 2002
- Commence design of the Butterfield Detention Basin
- Design Permanent Skate and BMX Park through volunteer community committee
- Complete construction of Butterfield Blvd. extension from San Pedro to Tennant
- Complete major street rehabilitation project

- Make improvements to increase capacity of Wastewater Treatment Plant to 8.5 MGD
- Aggressively deliver 5 year Capital Improvement Plan (CIP) of \$155 million

HIGHLIGHTS - FISCAL ISSUES

The total budget for Fiscal Year 2002/03 (including capital project appropriations, Redevelopment Agency appropriations, and transfers out) is \$86,287,768, or \$16,249,948 less than the original 2001/02 budget as a result of a reduction in capital projects for 2002/03. The budget includes a Capital Improvement Program (CIP) of \$27,325,000 for 2002/03. The budget also includes the addition of a net 4 full-time equivalent positions, as follows:

Community & Cultural Center: Five new full-time equivalent positions are proposed (1 Facility Manager, 1 Events Coordinator, 1.5 Maintenance Workers, 1 Municipal Services Assistant, and 0.5 Recreation Leader) to staff the new Community & Cultural Center and to provide new programs to the public.

Recreation: One position, the Leisure Services Coordinator position, is proposed for deletion in connection with the shift of certain Recreation programs to the Community & Cultural Center budget.

In addition, certain changes have been incorporated into the Budget as a result of a cost allocation consultant study and staff's determination that certain activities should be broken out as separate funds to ensure that certain monies are spent as legally required. In addition, staff wants to ensure that the City accurately provides financial information in an understandable and meaningful manner and accurately allocates costs.

CITY OF MORGAN HILL • FY 2002/03 • OPERATING AND CIP BUDGET | CITY OF MORGAN HILL • FY 2002/03 • OPERATING AND CIP BUDGET

· CITY OF MORGAN HILL · FY 2002/03 · OPERATING AND CIP BUDGET · CITY OF MORGAN HILL · FY 2002/03 · OPERATING AND CIP BUDGET · CITY OF MORGAN HILL · FY 2002/03 · OPERATING AND CIP BUDGET

Budget Message (continued)

well as direct, costs incurred by the General Fund on behalf of these other funds, as calculated by the City's cost allocation consultant. Previously, only direct costs incurred by the General Fund were allocated to these other funds.

- Collection of approximately \$130,000 in water and sewer usage fees from various City funds to cover the cost of providing these services to City facilities. Previously, these fees were not charged to the City.
- Addition of performance measures for many activities.

FUND SUMMARIES

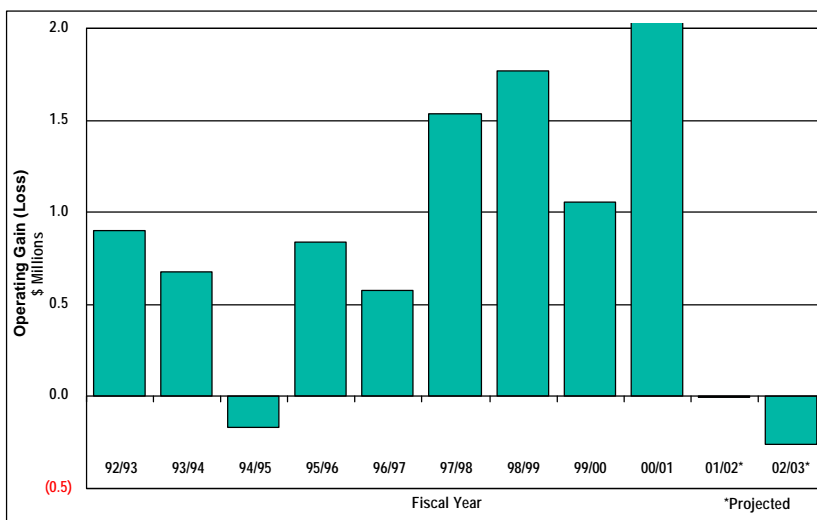
GENERAL FUND

The good news is that the available balance at 6/30/2002 is now projected to be \$10,748,694 including \$3,382,000 in designations. As revenues declined during 2001/02, staff projected, in October 2001, a \$1 million shortfall in 2001/02 budgeted revenue, which was primarily comprised of a significant drop in transient occupancy taxes. The City Council directed staff to offset approximately half of this shortfall by reducing 2001/02 expenditures in most General Fund departments by a target of 5% without reducing services to the public. The remainder of the shortfall was to be covered from reserves. In this Budget, staff now projects that General Fund departments will underspend the 2001/02 budget by 6%, which will exceed the City Council's target. This savings, combined with somewhat higher, but still reduced, 2001/02 revenue will result approximately in a slight decrease of <\$2,977> in fund balance for the 2001/02 fiscal year to the level of

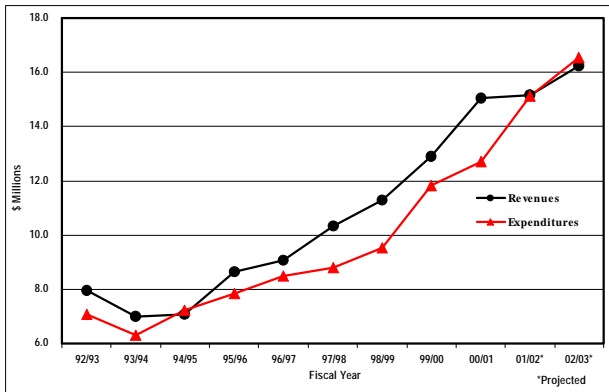
\$10,748,695 at 6/30/02. The budget for 2002/03 estimates that total fund balance will drop by <\$262,564> to \$10,486,131 at 6/30/03.

Revenues for the General Fund, including transfers in, are estimated to be \$16,246,408. This represents a 7% increase over the previous year's projected revenues, which is partly related to the inclusion of the new Community and Cultural Center budget in 2002/03, but not in the prior year. By excluding the \$889,000 in revenue related to this new activity, revenues would instead increase by 2%. Sales taxes and transit occupancy taxes are estimated to increase by 2.5% in 2002/03. In general, the 2001/02 Budget estimates reflect very modest growth for most General Fund revenues, as we expect that the economy will recover slowly over the next year.

Appropriations for 2002/03, including transfers out, are \$16,508,971, which represents a 3% increase compared to the prior year budget and a 9% increase compared to the prior year projected expenditures. However, if the \$889,000 in Community and Cultural Center activity, including \$175,000 in furnishings, is excluded from 2002/03, expenditures for the General Fund would decrease by 3% compared to the prior year budget or increase by 3% compared to the prior year projected expenditures.



CITY OF MORGAN HILL • FY 2002/03 • OPERATING AND CIP BUDGET I



The General Fund budget includes an additional \$120,000 in 2002/03, re-budgeted from the prior year, to assist the Morgan Hill Community Health Foundation in providing medical services to the community.

The two graphs below show that there has been a consistent General Fund operating surplus since 1992/93, except for a very small deficit in 1994/95, which has provided growth in fund balance up to June 2002. These surpluses have allowed fund balance to grow from \$504,095 at 6/30/92 to \$10,748,695, including designations, at 6/30/2003, as estimated.

uncertainty to cover the excess of proposed 2002/03 expenditures over revenues. The following summarizes the 2001/02 and 2002/03 designations:

By designating the \$3,319,436, the available undesignated fund balance for the General Fund would be \$7,166,694, or 43% of the \$16,508,971 budget, which is certainly a very safe reserve level. While not designated for specific purposes, the remaining \$7,166,694 is available for important purposes such as meeting cash flow needs, contingent liabilities for operational & facilities needs, future projects, and other designations to meet community needs.

Most of the General Fund is committed to Public Safety. Police appropriations are \$6,370,972 and Fire appropriations are \$3,623,938. The total of these amounts accounts for 61% of General Fund appropriations.

The remainder of the General Fund accounts for General Government operations (City Council, City Clerk, City Manager, Finance, Human Resources, and City Attorney) and

Designation Summary

<u>Designation Summary</u>	002/03	2002/03
	<u>2001/02</u>	<u>Changes</u>
		<u>Proposed</u>
• Designation for economic uncertainty:	\$1,182,000	(\$262,564)
• Designation for emergencies:	\$1,000,000	0
• Designation for Fire Master Plan Implementation:	<u>\$1,200,000</u>	<u>200,000</u>
Total Designations:	<u>\$3,382,000</u>	<u>(\$62,564)</u>
		<u>\$3,319,436</u>

In order to strategically plan for the future, it is appropriate for the City to explain the purpose of designations. Based upon this premise, a total of \$3.2 million was originally designated in the 2001/02 Budget, and this amount was increased during 2001/02 to \$3,382,000. Staff recommends that designations be adjusted to a new level of \$3,319,436 by the City Council. This includes adding \$200,000 to the designation for fire master plan implementation and using \$262,564 of the designation for economic

Park Maintenance and Recreation Services. A significant portion of the administrative cost is recovered in the form of charges to other City Departments for services performed. Operating costs for the new Community and Cultural Center are reflected in the General Fund, creating another opportunity and commitment. It is anticipated that this new, ongoing financial commitment, high on the City Council's priorities, can be absorbed by the General Fund in the years to come. A schedule of future anticipated revenues and expenditures for the Community and Cultural

Budget Message (continued)

Center is included in the special analysis section. For 2002/03, the \$889,311 in proposed operating costs for 58% of the fiscal year and the one-time furnishing costs are to be financed with \$368,979 in class revenue & rental income and with a \$520,332 transfer from the Community Center Fund previously established to provide start-up funds for new City recreational facilities.

Recommended transfers out of the General Fund for 2002/03 include a \$100,000 annual contribution to the Community Center Operations Fund to help meet the commitment to finance the operations of the Community and Cultural Center and the future Indoor Recreation Center. Staff also

included a \$377,000 transfer to the Street Maintenance Fund. A schedule reflecting the cost of street maintenance and the funding sources for past years and future years, as projected, is included in the special analysis section. A \$60,000 transfer to the General Plan Update Fund for the cost of the Greenbelt Study and other General Plan related costs not charged to other funds is also included in the Budget.

The most significant sources of General Fund revenues are:

- Sales Tax of \$5,330,000, or 33% of total estimated revenues

Discretionary Support	TOTAL	LESS	LESS	NET
Department	COSTS	DEPT	TRANSFERS	COSTS
		REVENUES	IN	
City Council/Community Promtns.	\$ 237,021	\$ 224,693		\$ 12,328
City Attorney	668,556	326,149		342,407
City Manager	393,276	221,650		171,626
Recreation	479,220	29,000		450,220
Community & Cultural Center	889,311	368,979	520,332	0
Human Resources	606,543	296,169		310,374
Volunteer Program	38,193	27,222		10,971
City Clerk	373,823	362,336		11,487
Elections	65,810			65,810
Finance	1,075,090	612,987		462,103
Medical Services	120,000			120,000
Police - Admin	596,573			596,573
Police - Patrol	3,131,616		270,000	2,861,616
Police - Support Services	867,088	296,150		570,938
Police - Emergency Services	89,549			89,549
Police - Special Operations	792,805			792,805
Fire Administration	3,623,938	65,050		3,639,078
Government Public Access	46,755	22,000		24,755
Communications & Marketing	116,982			116,982
Park Maintenance	826,483		100,000	726,483
Animal Control	71,918	25,000		46,918
Dispatch Services	821,421			821,421
Other Transfers Out	537,000		35,000	502,000
TOTALS	\$16,508,971	\$2,877,385	\$925,332	\$12,706,254
FINANCED BY DISCRETIONARY REVENUES				\$12,706,254

Budget Message (continued)

- Property taxes of \$2,008,000, or 12% of total estimated revenues
- Transient Occupancy Tax of \$892,000, or 5% of total estimated revenues
- Motor Vehicle State Subventions of \$1,965,000, or 12% of total estimated revenues
- General Administration Overhead of \$1,855,937, or 11% of total estimated revenues
- Franchise Fees of \$948,602, or 6% of total estimated revenues

The following chart shows how much of the 2002/03 General Fund budget is supported by discretionary general taxes and other revenues paid by residents and businesses. As shown below, all General Fund costs not recovered through departmental revenues (fees, grants, and reimbursements) are fully financed by discretionary revenues.

COMMUNITY DEVELOPMENT FUND

The Community Development Fund is a special revenue fund used to account for services supporting private development activity. The fund is dependent upon the collection of planning, building and engineering development fees to finance the Department's costs. This year appropriations are \$3,307,849, which represents a 7% decrease over the prior year's budget. Revenues in 2002/03 are estimated to be \$2,118,423, or 10% more than the prior year budgeted revenues. However, the proposed revenues for 2002/03 assume that community development fees, in total, will be increased by at least 20% through the adoption of higher fees by September 1, 2002, based upon a preliminary consultant study indicating that community development fees should be increased an average of 59% in order to fully recover costs. If fee increases are not adopted by the City Council, then sufficient funding is not expected to be available to finance the proposed 2002/03 Community Development Fund budget and proposed 2002/03 appropriations would need to be reduced. Staff is in the process of proposing a fee increase to the City Council.



Morgan Hill is just 30 minutes from San Jose International Airport, where new terminals, runways and roadways provide easy access and convenience to Silicon Valley travelers.



Highway 101 runs directly through Morgan Hill and easily connects business centers throughout the Bay Area



By 2015, jobs in Morgan Hill are projected to grow by nearly 120%, positioning the city as a strategic employment center in Silicon Valley.

The General Plan Update Fund continues to provide the resources for the General Plan Update. The 2002/03 program provides funding for the Greenbelt Study. The General Plan Update effort is critical for the City as it provides the basic policy blueprint on growth, development and services. This program is partially funded through a \$60,000 transfer from the General Fund.

Budget Message (continued)

STREET MAINTENANCE FUND

The Street Maintenance Fund is a special revenue fund used exclusively for street maintenance and traffic safety activities. Included are maintenance and repair of all roadways, streets, curbs, gutters, medians, roadway shoulders, and alleys; cleaning and repair of catch basins and storm drains; traffic engineering, safety studies and modifications, and related geographic information systems; street lighting and signal operations; and painting, marking, and striping. State gas tax funds are distributed based on population.

Revenues, including transfers in, are budgeted to be \$1,793,500, including \$644,000 of Gas Tax funds, \$117,000 of AB 2928 monies, \$377,000 in transfers from the General Fund, and \$600,000 in transfers from utility funds. Budgeted revenues, including transfers reflect a 0% increase over the prior year. The proposed 2002/03 transfer from the General Fund is \$107,000 more than in the prior year.

PARK MAINTENANCE FUND

When the City Council established this fund, it hoped to use it as an "endowment" fund for park maintenance and to pay for repairs and upgrades to existing parks. The interest received on the principal balance of the fund is to be appropriated strictly for maintenance of the City's parks. Revenues come from double park fees and from previous one-time general fund transfers of "excess" General Fund reserves.

The interest revenue from this park maintenance "endowment" fund normally generates at least \$100,000 per year in additional park maintenance funds that is used to pay for personnel in the Park Maintenance operation. This fund over time may resolve park maintenance concerns of City policy makers and residents. As described earlier in this message, approximately \$200,000 in open space fees have been removed from this fund and placed into a new "Open Space Fund."

SEWER AND WATER FUNDS

These are enterprise funds, where all costs incurred are covered by the fees and charges paid by users of the systems. Presently, the City has approximately 12,000 accounts (including residential and business customers). The City water system meets or exceeds water quality standards. Budget details on these funds are found under the Public Works section of the budget document listed as Water Operations and Sewer Operations.

The Sewer Operations Fund budget of \$6,875,234 represents a 1% increase over the prior year budget, while the Water Operations Fund budget of \$7,924,609 represents a 12% increase over the prior year. Sufficient fund balance, combined with estimated revenues, exists within each of these funds to fully finance these costs. A study of the sewer and water rates by a consultant is underway and the results will be brought to the City Council on May 22, 2002, so that appropriate steps may be taken to make corrections to sewer and water rates for the long-term, considering the resources on hand and future capital needs.

INTERNAL SERVICE FUNDS

Internal Service funds are essentially responsibility centers within the City that provide services to other departments. These other departments are then charged for the portion of services provided to them by the respective internal service responsibility center. These funds include Equipment Replacement, Information Systems, Building Maintenance, CIP Administration, and various Insurances.

CAPITAL PROJECTS FUNDS

Total capital projects are budgeted at \$27,325,000, as reflected in the CIP attached as an appendix. The capital projects budget is comprised of:

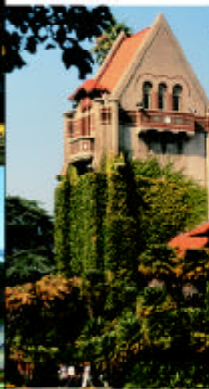
CITY OF MORGAN HILL • FY 2002/03 • OPERATING AND CAPITAL BUDGET

- Sports Complex – Aquatics portion (\$1.6 million for design/professional services)
- Sports Complex – Sports Field portion (\$2.5 million for site acquisition)
- Police Facility (\$1 million for site acquisition)
- Community Indoor Recreation Center (\$1.6 million for design/professional services)
- Sewer Plant Improvement Project (\$3.9 million for construction)
- Butterfield Retention Basin (\$1.9 million for site acquisition)
- Butterfield Blvd. Construction-San Pedro to Tennant (\$3.9 million - construction)
- Pavement Rehabilitation Program (\$1.5 million for construction)

Many of these projects are possible because of the referendum for the Plan Amendment to the 1981 Ojo de Agua Redevelopment Plan that was approved by the voters in November 1999. Of the total \$27.3 million in capital projects described in the CIP for 2002/03, \$12.8 million will be financed by the Redevelopment Agency.

- ## THREATS TO THE BUDGET

This recommended budget reflects a plan to meet our obligations based on changes in local revenues. However, it is possible that the Governor and Legislature may propose to shift revenues and costs in order to balance the State Budget. Based on the Governor's promise, we have not anticipated any reduction in the motor vehicle in lieu fee revenues.



Morgan Hill employers are served by skilled job seekers from more than six community colleges and world-class universities such as San Jose State, Santa Clara and Stanford.



Serving a diverse community,
Morgan Hill schools are
recognized for their
achievements in innovation,
dynamic partnerships,
exceptional programs
and support services.

CITY OF MORGAN HILL • FY 2002/03 • OPERATING AND CIP BUDGET • CITY OF MORGAN HILL • FY 2002/03 • OPERATING AND CIP BUDGET •

I wish to acknowledge my appreciation to the members of the City Council for your continued support of programs that deliver necessary public services and for their sound fiscal policy. I also wish to express my appreciation to the talented and dedicated City staff for their assistance in the development of this budget.

Respectfully submitted,



J. Edward Tewes
City Manager

The City has very healthy reserves and resources are on hand or will be available to accomplish the major Visioning projects that the community desires. The City has the opportunity to prudently expand services to meet the demands of a growing community and the opening of new facilities, yet still maintain appropriate financial reserves. While growth in revenue over the next year is projected to be small, we expect that the economy will fully recover after next year and return to the more typical growth in revenue. The strong reserves maintained by the City reflect the foresight of the City Council and community.